

# **HOW MUCH IS ENOUGH?**

*An Analysis of the Diocese of Rockville Centre “Free Cash Reserves”*

As of August 31, 2006

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## Table Of Contents

<b>EXECUTIVE SUMMARY .....</b>	<b>3</b>
<b>II. INTRODUCTION AND BACKGROUND .....</b>	<b>6</b>
<b>III. RESULTS AND DISCUSSION OF THE ANALYSIS .....</b>	<b>8</b>
CALCULATION OF “FREE CASH RESERVES” .....	8
ANALYSIS OF THE “FREE CASH RESERVES” .....	10
OPERATIONAL TRENDS.....	15
<b>IV. DIOCESAN COUNTERARGUMENTS.....</b>	<b>16</b>
<b>V. OTHER DEVELOPMENTS, INCLUDING THE INDEPENDENT VOLUNTEER ACCOUNTANTS AND CONSULTANTS GROUP REPORT .....</b>	<b>19</b>
<b>VI. CONCLUSIONS .....</b>	<b>21</b>
<b>VII. OTHER DOCUMENTS AVAILABLE UPON REQUEST .....</b>	<b>24</b>
<b>VIII. ATTACHMENTS .....</b>	<b>25</b>
<b>ATTACHMENT I: CALCULATION OF DRVC “FREE CASH RESERVES” AS OF 8/31/06 – DIRECT METHOD .....</b>	<b>26</b>
<b>ATTACHMENT I: CALCULATION OF DRVC “FREE CASH RESERVES” AS OF 8/31/06 – INDIRECT METHOD .....</b>	<b>27</b>
<b>ATTACHMENT II: KEY CASH RESERVE AMOUNTS/RATIOS/INDUSTRY COMPARISONS</b>	<b>28</b>
<b>ATTACHMENT III: SUMMARY OF MAJOR CHANGES REFLECTED IN THE DRVC FISCAL 2006 FINANCIAL STATEMENTS .....</b>	<b>29</b>
<b>ATTACHMENT IV: MAJOR COMPONENTS OF FREE CASH RESERVES (“FCR”) AS OF AUGUST 31, 2006 .....</b>	<b>32</b>
ADMINISTRATIVE OFFICES .....	32
MISSION ASSISTANCE CORPORATION.....	33
PROTECTED SELF INSURANCE FUND.....	33
HEALTH INSURANCE PROGRAM.....	34
CATHOLIC CEMETERIES.....	34
CATHOLIC CHARITIES.....	35
ALL OTHER DIOCESAN ENTITIES COMBINED .....	36
<b>ATTACHMENT V: SPECIFIC METHODOLOGY USED TO CALCULATE DRVC “FREE CASH RESERVES” .....</b>	<b>37</b>
GENERAL DESCRIPTION.....	37
DETAILED DESCRIPTION OF THE “DIRECT METHOD” .....	37
DETAILED DESCRIPTION OF THE “INDIRECT METHOD” .....	38
<b>ATTACHMENT VI: FORMULA USED TO CALCULATE “DEFINED OPERATING EXPENSES” .....</b>	<b>39</b>
<b>ATTACHMENT VII: ANALYSIS OF SEPTEMBER 6, 2006 LONG ISLAND CATHOLIC ARTICLE, “DIOCESAN RESERVES EXPLAINED” .....</b>	<b>40</b>
<b>ATTACHMENT VIII: SELECT FINANCIAL METRICS FOR 2006 .....</b>	<b>43</b>

## EXECUTIVE SUMMARY

The Diocese of Rockville Centre (“DRVC”) has been accumulating excess cash reserves for many years. These reserves far exceed the amount needed to support operations, pay liabilities and provide a reasonable cushion for unexpected contingencies. Most of these excess reserves, which I call “free cash reserves”, are available for general use and could be used to further the mission of the Church, particularly its humanitarian mission, instead of collecting interest in DRVC coffers and being increased with each year’s operating surplus.

I have been analyzing Diocesan excess reserves now for five years in an attempt to hold the Diocese accountable for its accumulation policies and to encourage the DRVC to use more of these excess reserves for its various missions. During that time, the Diocese has made some improvements in the quality of its financial reporting, but it has done very little to use its free cash reserves in a more responsible way. In addition, the DRVC has largely given “lip service” to the substance of my analysis and has issued a series of weak arguments and misinformation in defense of its policies. I have tried to be fair and balanced in this report, but I encourage you to read it and draw your own conclusions, keeping in mind foundational Christian principles concerning stewardship.

Based upon my analysis of the latest DRVC audited financial statements (fiscal year ended August 31, 2006), free cash reserves now equal \$267.7 million, an \$11.5 million increase from the previous year restated amount of \$256.2 million. Free cash reserves have now increased by at least \$5.2 million in every year I have done this analysis (five years), or a total of \$35.4 million.

This year’s analysis was completed before the final two financial statements were published by the Diocese. It is unclear whether or not such financials will ever be published, and 18 months have already elapsed since the fiscal 2006 year-end (August 31, 2006). If these final two statements are eventually issued, they are not expected to result in a material change to the amounts included herein.

New auditors in 2006 required that the Diocese make certain restatements of prior year financial statements, which had the effect of increasing free cash reserves by \$68.6 million. Accordingly, all prior year amounts presented in my report have been restated by such amount.

The following amounts (derived from the 2006 financial statements) demonstrate the significance of these free cash reserves:

- 1. \$267.7 million of “free cash reserves”**---This is equivalent to 4.9 years of annual “defined operating expenses” vs. an accepted industry standard of no more than 1 year. Thus, free cash reserves exceed the industry standard by 3.9 years or \$212.7 million.
- 2. \$131.5 million of unrestricted net assets in excess of a Better Business Bureau industry standard**---The DRVC has unrestricted net assets of \$296.5 million, which is \$131.5 million more than the maximum allowed by a Better

Business Bureau Wise-Giving Alliance “Standard of Charity Accountability”. As a result, the DRVC does not qualify for the BBB “Wise Giving Seal” because it has accumulated unrestricted net assets far in excess of the maximum allowed. The BBB discourages donors from giving to a cause that fails this test.

- 3. \$139.2 million of unrestricted cash and marketable securities in excess of total liabilities**---In other words, the DRVC could pay-off all its liabilities and still be left with **all** of its tangible assets **plus** \$139.2 million of cash and marketable securities. That’s before considering the appreciated but unrecorded value of certain of its assets, such as the Seminary of the Immaculate Conception.
- 4. An annual increase in free cash reserves of \$5-12 million**---The DRVC continues to increase its free cash reserves at the rate of \$5-12 million per year---\$11.5 million, \$5.2 million, \$6.5 million and \$12.2 million in fiscal years 2006-2003, respectively. (Note: While these increases were occurring, the DRVC engaged in a process of cutting back programs needed by many in our community and regularly pleaded for greater financial support from parishioners.)
- 5. A current ratio of 7.8 (current assets of \$366.2 million are 7.8 times current liabilities of \$46.9 million)**---According to a prominent non-profit textbook, “any measure (current ratio) beyond 2.0 suggests the possibility of inefficient uses of cash that might be better employed to fund (other activities)”. Our Diocese has a current ratio far in excess of 2.0---7.8 to be exact---primarily due to its large free cash reserves.

Although a significant portion of the free cash reserves has been “designated” for future use, such designations are discretionary (not required under generally accepted accounting principles) and merely indicate a possible use for such reserves in the future. In addition, most of the “designations” are quite vague, unspecific, general, redundant and/or inconsistent with past DRVC practice. In other words, it is unreasonable to assume that the DRVC needs these unrestricted but “designated” reserves for the purposes described.

In 2007, a non-paid, independent Volunteer Accountants and Consultants Group (“VAC”) reviewed my report on 2005 DRVC finances and determined that my findings were “supportable” and my conclusions “reasonable”.

In addition, in a September, 2006 article published in The Long Island Catholic, the DRVC basically confirmed that it does have approximately \$200 million (before restatement) of unrestricted cash reserves although it continued to argue that most of these funds were needed for future “designated” purposes. As noted above, most of these “designations” are discretionary and appear to lack substance. The Volunteer Accountants and Consultants Group agrees with me on this point and goes on to say that, “The Diocese of Rockville Centre appears to have no clear, specific and measurable

policy regarding the designation of these surplus funds.” (See a more detailed discussion of the VAC report in **SECTION V---OTHER DEVELOPMENTS**)

The existence of these excess cash reserves raises several important questions for Long Island Catholics, which remain unanswered:

1. Why doesn't the DRVC have an effective mechanism in place to balance the growing human and parish needs in the community with its apparent tendency to accumulate more excess reserves? Does the lack of such a mechanism represent good stewardship in an organization that prides itself on foundational Christian principles?
2. Do guidelines exist to determine when reserves become excessive and/or when existing reserves should be spent on high priority human needs, even if this means temporarily dipping into such reserves?
3. If reserves are “adequate” as the Chairman of the Finance Council admitted several years ago, then why shouldn't at least a portion of subsequent increases (approximately \$5-12 million per year) be allocated to high priority social and humanitarian needs?
4. If \$267.7 million is not enough, then **HOW MUCH IS ENOUGH?** If reserves that are many times annual operating expenses and which far exceed industry and Better Business Bureau standards, are not enough, then **HOW MUCH IS ENOUGH?**

## II. INTRODUCTION AND BACKGROUND

The purpose of my analysis is to quantify the amount of “free cash reserves” maintained by the Diocese of Rockville Centre (“DRVC”) and to encourage the DRVC to use more of these reserves to fulfill its various missions, particularly those related to humanitarian needs. Such reserves are already excessive by every industry standard I have been able to find and are growing at an alarming rate. This is simply not right given the growing human needs in our community. We should not sit idly by while the DRVC continues to accumulate even more reserves. However, before getting into specifics, it may be helpful to review a little history.

The DRVC began publishing complete audited financial statements for the first time for its fiscal year ended August 31, 2002. This was done at the urging of the U.S. Conference of Catholic Bishops. The financial statements published then and now by the DRVC are individual statements for the Administrative Offices and the various Diocesan operating entities. They have not been combined or consolidated in any fashion and do not include the parishes, non-diocesan schools or Catholic Health Systems. Consequently, they are quite difficult to understand. However, it quickly became apparent to me from this first set of statements that the DRVC was sitting on an enormous amount of unrestricted cash and marketable securities, or what I call “free cash reserves” (see the definition of “free cash reserves” under **SECTION III---RESULTS AND DISCUSSION OF THE ANALYSIS** and **Attachment V---Specific Methodology Used to Calculate Free Cash Reserves**). The existence of such a large amount of cash reserves is troubling given the spiritual and humanitarian mission of the Church. So I began an analysis, which confirmed my initial impressions.

I communicated the results of my initial analysis, together with my concern about the accumulation of such large, excess cash reserves, to the Bishop and his financial management in 2003. After an initial exchange of correspondence, the DRVC discontinued all further communication with me. After several more unsuccessful attempts at communication with the DRVC in 2003 and 2004, I began sharing my analysis with the Long Island Voice of the Faithful although I continued to perform the analysis in a completely independent manner.

I have now performed a similar analysis of the audited DRVC financial statements for five years (fiscal years 2002-2006). Each time the result was the same: The DRVC has a very large amount of free cash reserves, which is actually growing on an annual basis by \$5-12 million. The DRVC and Diocesan Finance Council have never quarreled with the basic methodology used or the amount calculated in any of these analyses. However, they have offered a string of justifications for the existence of the free cash reserves and need thereof (see “**DIOCESAN COUNTERARGUMENTS**” later in this report for a more detailed discussion of these justifications). After I refuted each justification, the DRVC seemed to develop a new “theory”, which was generally just as weak as the one before.

I refined my analysis each year to improve its accuracy, validity and/or understandability. In addition, I identified certain non-profit industry standards concerning the appropriate amount of reserves that should be maintained by a Church diocese, and I compared these

standards to the results of my analysis. These comparisons are summarized under “**RESULTS AND DISCUSSION OF THE ANALYSIS**”. As noted above, each such analysis and the related industry comparisons have confirmed my initial conclusion that the DRVC has, in fact, accumulated a very large amount of free cash reserves, and such amount is growing at the alarming rate of \$5-12 million per year.

Summaries of my analyses have been published in Newsday and posted to the LI Voice of the Faithful website ([www.votf-li.org](http://www.votf-li.org)) only after giving the DRVC the opportunity to respond to them, which it generally did not do.

In late 2005, Bishop Murphy invited me to a meeting with him to discuss my analysis and views. He used the opportunity to present his case for not using more of the Diocesan free cash reserves for the various missions of the Church. His arguments were very weak, in my opinion, and the meeting essentially was unproductive (see “**DIOCESAN COUNTERARGUMENTS**” later in this report for a more detailed discussion of Bishop Murphy’s arguments and why I consider them very weak). He offered to answer any follow-up questions in writing. However, I never received a response to 28 questions I subsequently submitted to him and his Chief Financial Officer.

In late 2006, The Long Island Catholic published a two page article entitled, “Diocesan Reserves Explained”. This article acknowledged the existence of \$200.4 million (before restatement) of unrestricted net assets (“reserves”), which basically confirmed my analyses. The article also attempted to justify the need for these reserves. Unfortunately, the justifications were more noteworthy for what they didn’t say than what they did say and for a lot of misleading information, inaccuracies and half-truths. My analysis of what the article said and didn’t say can be found at **Attachment VII**.

In 2007, a non-paid, independent Volunteer Accountants and Consultants Group (“VAC”) reviewed my report on 2005 DRVC finances and determined that my findings were “supportable” and my conclusions “reasonable” (see a more detailed discussion of the VAC report later in this report at **SECTION V---OTHER DEVELOPMENTS**).

### **III. RESULTS AND DISCUSSION OF THE ANALYSIS**

#### *Calculation of “Free Cash Reserves”*

There is no specific definition of “free cash reserves” in accounting literature. However, free cash reserves are generally considered to be unrestricted cash and marketable securities not needed for the payment of operating expenses and available for general use. The specific methodology I used to calculate free cash reserves is explained in **Attachment V---“Specific Methodology Used to Calculate Free Cash Reserves”**. I believe that my methodology is quite conservative and gives the DRVC the benefit of the doubt in most respects. Basically, I added (combined) all the cash (including marketable securities) held by each Diocesan entity and then deducted any restricted cash and securities. I also deducted any other restricted assets whose nature was unclear and any “net liabilities” that individual Diocesan operating entities had. Finally, I deducted the Diocesan “Uninsured Perils Fund” on the assumption that it would be needed to pay sexual abuse claims and related costs even though such fund is labeled as unrestricted. That left me with what I considered to be “free cash”, i.e., unrestricted cash not needed for the payment of operating expenses or “net liabilities” and available for general Diocesan use. The calculation looks like this:

**Add (combine) all cash and marketable securities**  
**Subtract: All restricted cash and marketable securities**  
**Subtract: Assets held in custody for other entities, including the “Deposit and Loan Account” and Unitas Investment Fund deposit liabilities**  
**Subtract: Other restricted assets possibly containing some cash or securities**  
**Subtract: Liabilities of individual Diocesan operating entities in excess of their non-cash assets (“net liabilities”) and the “Uninsured Perils Fund”, which although unrestricted is assumed needed for sexual abuse claims and related costs**  
**Equals “Free Cash Reserves” (“FCR”)**

Using information derived from the latest DRVC audited financial statements (fiscal 2006), the calculation results in the following amounts:

**Total Cash and Cash Equivalents Held by the  
Diocese of Rockville Centre**

	<u>Notes</u>	<u>Amount</u>
Cash and marketable securities	1	\$698,985,000
Less: Deposit/custodial liabilities	2	(380,092,000)
Restricted invests, assets, etc.	3	<u>(24,946,000)</u>
Unrestricted cash and marketable securities		293,947,000
Less: "Net liabilities"	4	<u>(26,226,000)</u>
<b>FREE CASH RESERVES</b>		<b><u><u>\$267,721,000</u></u></b>
<b>Designation Status</b>	5	
Undesignated portion		\$70,838,000
Designated for future use		196,883,000
<b>FREE CASH RESERVES</b>		<b><u><u>\$267,721,000</u></u></b>

**Notes**

The information presented here is derived from the most recently issued financial statements of the Diocese of Rockville Centre on a combined (all of its entities added together) basis. FCR on an entity-by-entity basis can be found on the schedule following this schedule and at Attachment I. This analysis excludes all other non-cash assets, including receivables, land, buildings and other assets owned by the Diocese.

- 1) Cash and cash equivalents includes investments in marketable securities that can be quickly converted to cash.
- 2) This amount (\$380,092,000) represents the amount of cash being held by the Diocese in a pooled investment fund on behalf of other entities, including parishes. This analysis deducts all such cash under the assumption that such entities separately own and have a right to use such cash without interference from the Diocese.
- 3) This amount represents cash that has been identified as "restricted" according to the financial statements. All "restricted" cash has been deducted in this analysis as have other restricted assets (whose composition is uncertain).
- 4) This amount represents the amount by which total liabilities exceed total non-cash assets for all entities where this condition exists. It also includes the Uninsured Perils Fund, which is unrestricted but assumed needed for the sexual abuse claims.
- 5) An entity (or the Diocese) may on a mostly discretionary basis "designate" some of its cash reserves for future uses. \$196,883,000 of the free cash reserves have been so "designated". No particular purpose has been associated with the remaining \$70,838,000 of free cash reserves.

Here is the same calculation on an entity-by-entity basis (in thousands of dollars):

ITEM (In Thousands)	ADMIN OFFICE	MISSION ASSIST.	CATH. CHAR.	SELF INS. PROGRM	HEALTH INS. PRG.	CATH. CEMET.	TOTAL	OTHER ENTITIES	GRAND TOTAL
Cash/marketable securities	\$67,073	\$4,688	\$21,998	\$80,468	\$24,585	\$114,634	\$313,446	\$385,539	\$698,985
Less:									
Deposit/ custodial liabilities	(10,044)	-	-	-	-	-	(10,044)	(370,048)	(380,092)
Restricted invests./assets	(10,457)	-	(1,658)	(8,870)	-	(11)	(20,996)	(3,950)	(24,946)
Unrestricted cash and marketable securities	\$46,572	\$4,688	\$20,340	\$71,598	\$24,585	\$114,623	\$282,406	\$11,541	\$293,947
Less: "Net liabilities"	-	-	-	(23,181)	(1,260)	-	(24,441)	(1,785)	(26,226)
<b>"FREE CASH RESERVES"</b>	<b>\$46,572</b>	<b>\$4,688</b>	<b>\$20,340</b>	<b>\$48,417</b>	<b>\$23,325</b>	<b>\$114,623</b>	<b>\$257,965</b>	<b>\$9,756</b>	<b>\$267,721</b>
Undesignated portion	\$35,220	\$0	\$288	\$0	\$0	\$29,461	\$64,969	\$5,869	\$70,838
Designated for future use	11,352	4,688	20,052	48,417	23,325	85,162	192,996	3,887	196,883
<b>"FREE CASH RESERVES"</b>	<b>\$46,572</b>	<b>\$4,688</b>	<b>\$20,340</b>	<b>\$48,417</b>	<b>\$23,325</b>	<b>\$114,623</b>	<b>\$257,965</b>	<b>\$9,756</b>	<b>\$267,721</b>

See **Attachment I—Direct Method** which contains certain additional footnotes that should be read in conjunction with this calculation. **Attachment I** also contains an “Indirect Method” of calculating the free cash reserves, which has been used in past years, and results in exactly the same amounts.

As noted earlier, this year’s analysis was completed before the final two financial statements were published by the Diocese. It is unclear whether or not such financials will ever be published, and 18 months have already elapsed since the fiscal 2006 year-end (August 31, 2006). If these final two statements are eventually issued, they are not expected to result in a material change to the amounts included herein.

In addition, new auditors in 2006 required the DRVC to make three restatements of prior year financial statements, two of which had the effect of increasing free cash reserves by \$68.6 million. As a result, prior year free cash reserve amounts presented below together with the related ratios and industry comparisons have been similarly restated by \$68.6 million in order to maintain their comparability. For more information on these restatements, see **Attachment III.**)

Analysis of the “Free Cash Reserves”

**Attachment II---Key Cash Reserve Amounts/Ratios/Industry Comparisons, Attachment III---Summary of Major Changes in the Fiscal 2006 Financial Statements and Attachment IV---Major Components of Free Cash Reserves** all provide a detailed discussion of the results of the calculations and changes between fiscal

years 2003-2006. The following is a briefer summary of the information contained in such attachments. All dollar amounts presented are in millions:

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Free cash reserves	\$244.5	\$251.0	\$256.2	\$267.7
Increase from prior year	\$ 12.2	\$ 6.5	\$ 5.2	\$ 11.5
Amount of free cash reserves in excess of the <u>maximum</u> industry standard (1 year of operating expenses)	\$189.5	\$196.0	\$201.2	\$212.7
Number of years of defined operating expenses available in the form of free cash reserves (compared to the <u>maximum</u> industry standard of 1 year)	4.4	4.6	4.7	4.9
Unrestricted net assets	\$278.8	\$286.1	\$289.2	\$296.5
Amount of unrestricted net assets in excess of the <u>maximum</u> industry standard (3 years of operating expenses per BBB Charity Accountability Standard #10)	\$113.8	\$121.1	\$124.2	\$131.5
Number of years of defined operating expenses available in the form of unrestricted net assets (compared to the BBB <u>maximum</u> standard allowed of 3 years)	5.1	5.2	5.3	5.4
Current assets in excess of current liabilities	NA	NA	\$324.0	\$319.3
Current ratio---current assets divided by current liabilities (compared to the industry standard of 2.0)	NA	NA	9.1	7.8
Total unrestricted cash	\$279.9	\$288.3	\$282.8	\$293.9
Unrestricted cash less total liabilities	\$158.3	\$153.1	\$134.6	\$139.2
Undesignated portion of free cash reserves	NA	NA	NA	\$ 70.8

(Note: Some of these ratios have been calculated using “defined operating expenses” instead of total operating expenses per the financial statements. The reason for this is explained later and in Attachment VI.)

As can be seen from this summary, the DRVC has accumulated an enormous amount of cash reserves, including the following:

- 1. \$267.7 million of “free cash reserves”**---This is equivalent to 4.9 years of annual “defined operating expenses” vs. an accepted industry standard of no more than 1 year. Thus, “free cash reserves” exceed the industry standard by 3.9 years, or \$212.7 million. In addition, these reserves grew by another \$11.5 million in 2006.
- 2. \$70.8 million of “undesignated”, unrestricted free cash reserves**---This is the amount of free cash reserves that the DRVC basically can’t even think of a future use for.
- 3. \$131.5 million of excess unrestricted net assets**---The Better Business Bureau (“BBB”) Wise Giving Alliance has established “Standards for Charity Accountability”. Standard #10 mandates that charities:

*“Avoid accumulating funds that could be used for current program activities. To meet this standard, the charity’s unrestricted net assets available for use should not be more than three times the size of the past year’s expenses”.*

The DRVC has unrestricted net assets of \$296.5 million, which is equivalent to 5.4 times defined annual operating expenses vs. the maximum permitted of 3.0 times. This is 2.4 times and \$131.5 million more than the maximum allowed by the standard. As a result, the DRVC does not qualify for the BBB “Wise Giving Seal” because it has accumulated unrestricted net assets far in excess of the maximum allowed. The BBB Wise Giving Alliance discourages donors from contributing to charities that exceed its standard since such charities are viewed as not effectively fulfilling their mission with available resources.

- 4. \$139.2 million of unrestricted cash and marketable securities in excess of total liabilities**---In other words, the DRVC could pay-off all its liabilities and still be left with **all** of its tangible assets **plus** \$139.2 million of cash and marketable securities. And, that’s before considering the appreciated but unrecorded value of certain of its assets, such as the Seminary of the Immaculate Conception. In the corporate world, the DRVC would be regarded as a “cash cow”.
- 5. An increase in free cash reserves in fiscal 2006 of \$11.5 million from fiscal 2005**---This increase is consistent with that of past years when the increase ranged between \$5 million and \$12.2 million per year (\$5.2 million in 2005, \$6.5 million in 2004 and \$12.2 million in 2003 excluding a one-time \$7.8 million contribution to the religious inter-diocesan pension fund without which the increase would have been \$20 million). These increases occurred even while the DRVC was engaged in a process to cut back programs needed in our community and regularly pleading for greater financial support.

- 6. A current ratio of 7.8, which substantially exceeds the industry standard of 2.0**---A prominent non-profit textbook, Financial Accounting and Analysis in Nonprofit Organizations, states that “the ideal bill-paying ability (for non-profit organizations) ranges between a (current) ratio of one and two...Any measure beyond two suggests the possibility of inefficient uses of cash that might be better employed to fund programs”.
- 7. Virtually no long-term debt**--- Although not listed in the table above, the DRVC had only \$14.3 million of long-term debt as of August 31, 2006 compared to net assets of \$312.8 million. This represents a debt to equity ratio of 4.6%. This ratio is so low compared to industry norms that it provides further evidence of poor utilization of Diocesan resources.

The \$267.7 million of free cash reserves is scattered among all Diocesan entities. However, as can be seen below, six entities possess the vast majority of such reserves (also see **Attachment IV** for a detailed discussion of these free cash reserves on an entity-by-entity basis, including arguments for and against their need):

**FREE CASH RESERVE AMOUNT**

<b><u>Entity</u></b>	<b><u>Restated 2005</u></b>	<b><u>2006</u></b>	<b><u>Increase/ (Decrease)</u></b>
	(In millions)		
Administrative Offices	\$ 54.4	\$ 46.6	\$ (7.8)
Mission Assistance Corporation	0	4.7	4.7
Protected Self Insurance Program	48.4	48.4	0
Health Insurance Program (2005 Restated)	18.1	23.3	5.2
Catholic Cemeteries (2005 Restated)	109.9	114.6	4.7
Catholic Charities	20.1	20.3	.2
All Other Entities	<u>5.3</u>	<u>9.8</u>	<u>4.5</u>
<b>TOTAL</b>	<b><u>\$256.2</u></b>	<b><u>\$267.7</u></b>	<b><u>\$ 11.5</u></b>

The largest increases in free cash reserves in 2006 occurred at Catholic Cemeteries and the Health Insurance Program while the largest decrease occurred at the Administrative Offices. However, the decrease at the Administrative Offices resulted primarily from the transfer of excess cash in the form of start-up capital to the newly-established Mission Assistance Corporation and similar transfers to other DRVC entities which had the effect of reducing the Administrative Offices FCR while increasing the FCR of other DRVC entities (see **SECTION V---OTHER DEVELOPMENTS**, Item #4 for more details concerning these transfers). The increase at Catholic Cemeteries resulted from operations and is consistent with prior year increases.

The DRVC argues that it needs all of these reserves and the annual increases therein for various purposes. However, the facts, including historical usage, do not support such arguments. The DRVC also argues that it does not control the individual entities that possess these reserves and cannot, therefore, dictate the use of such reserves. To the

contrary, it's apparent from past "dividends" paid by certain of these entities to the Administrative Offices and other actions taken by the Administrative Offices over the years that the Administrative Offices exercise effective control over these reserves. Were this not the case and were these separate entities to have some control over their own free cash reserves, there is still no compelling reason why such reserves could not be used "in place" by each of the entities to fulfill its own sub-mission rather than continue to be grown to ever-greater excessive amounts. As a matter of fact, Catholic Charities seems to be doing just that beginning in 2005 although it's unclear whether this is the result of a policy decision or other factors (see **Attachment IV**).

The DRVC has masked (intentionally or unintentionally) the true nature of many of these unrestricted cash reserves by "designating" them for some possible future use. Such designations are discretionary (not required under generally accepted accounting principles) and merely indicate a possible use for such reserves in the future. In addition, most of the DRVC "designations" are quite vague, unspecific, general, redundant and/or inconsistent with past DRVC practice. In other words, it is a real "stretch" to assume that the DRVC will need these unrestricted but "designated" reserves for the purposes described. In reaching this conclusion, I used the following five criteria:

1. Is the designated reserve redundant due to the existence of actual liabilities or other reserves established for the same purpose?
2. Has the reserve been designated as a "quasi-endowment fund" intended to produce income to support operations even though it was not donated for that purpose?
3. Do past practices of the DRVC suggest that the reserve will not be used for the purpose designated?
4. Do other facts (e.g., historical expenses, independent actuarial studies, etc.) suggest that the designated reserve won't be needed for the purpose designated?
5. Is the description of the designated reserve so vague or subjective as to suggest that the reserve though designated may be excessive?

If the answer to any of these questions was "yes", the designated reserve was considered to be excessive, i.e., a "free cash reserve". The independent Volunteer Accountants and Consultants Group, which reviewed my analysis, agreed that these criteria were reasonable and even went on to say, as noted earlier, that, "The Diocese of Rockville Centre appears to have no clear, specific and measurable policy regarding the designation of these surplus funds."

Finally, some of these reserves have been designated by the DRVC as a "quasi-endowment fund", which was accumulated over a period of years from contributions by parishioners and others. They certainly never intended their contributions to be set aside in a "quasi-endowment fund" vs. being used currently for the needs of the Diocese and community.

### Operational Trends

The following are some key operating financial statistics for the DRVC on a combined, unaudited basis in millions of dollars (see **Attachment VIII** for more statistics):

	<b>Restated</b>		<b>Increase</b>
	<b>2005</b>	<b>2006</b>	<b>(Decrease)</b>
Revenues	\$214.5	\$232.1	\$17.6
Expenses	209.0	223.2	14.2
Increase in Net Assets (Surplus)	5.5	9.0	3.5
Net Assets	304.3	312.8	8.5
Unrestricted Net Assets	289.2	296.5	7.3
Unrestricted Cash and Marketable Securities	282.8	293.9	11.1
Current Assets	363.9	366.2	2.3
Current Liabilities	39.9	46.9	7.0
Total Liabilities	148.2	154.7	6.5
Long-Term Debt	11.5	14.3	2.8

**NOTE:** 2005 amounts have been restated to reflect two accounting changes required by new auditors in 2006 and one accounting change resulting from the adoption of a new accounting principle by the DRVC. The 2006 Increase in Net Assets does not include the \$13.4 million cumulative effect of a change in accounting principle. See **Attachment III** for more details on these accounting changes.

Combined DRVC revenues continued to increase by about the same amount as expenses in 2006, which attests to the ability of the DRVC to “pass-through” whatever its cost increases are to the parishes, ministries and others. This is particularly true for the two self-insurance funds, which have a significant amount of free cash reserves but continue to assess the parishes and ministries an amount equivalent to or greater than cost. The Cemetery revenue seems to be declining somewhat, perhaps indicating that Holy Rood is nearing capacity. However, cemetery operations still produced a substantial profit, which was slightly greater than the prior year. Catholic Charities continues to operate about break-even (including its Catholic Ministries Appeal allocation) and spent most of its investment income to support operations and mission vs. building more free cash reserves.

Despite rising expenses and lower cemetery revenue, the DRVC still operated at a \$9 million surplus in 2006 vs. \$5.5 million in 2005. The operating surplus is roughly equivalent to and largely responsible for the increase in free cash reserves of \$11.5 million. See **Attachment III** for a discussion of other significant trends and variations noted in the 2006 financial statements and **Attachment VIII---Select Financial Metrics for 2006** for an entity-by-entity summary of key financial data.

#### **IV. DIOCESAN COUNTERARGUMENTS**

As noted above (and in **Attachment IV---Major Components of Free Cash Reserves**), the DRVC believes it needs its large, excessive (by industry standards) cash reserves for possible, future uses. This is its principle argument for maintaining such reserves, which I will now refute.

Because the DRVC believes it needs these free cash reserves for possible, future uses, it has “designated” them for such uses even though they don’t meet the basic criteria for designation summarized above. It should be noted that there is no requirement under generally accepted accounting principles (“GAAP”) to set aside “designated net assets”. **They are not liabilities, and they are not restricted assets.** They are more like retained earnings in private industry, which can be reinvested or distributed as dividends as management sees fit. Non-profit entities are allowed under GAAP to judgmentally divide their unrestricted net assets between such designated and undesignated portions. There are no specific rules or guidelines for doing this. The process is quite discretionary and normally only requires board of trustee or finance council approval. So, the fact that some portion of the free cash reserves has been “designated” does not prove that they are needed.

As noted above, I examined the specific uses designated by the DRVC for its reserves using five basic criteria. As a result, I determined that, for the most part, such designations are lacking in real substance. In addition, the Volunteer Accountants and Consultants Group determined my five criteria to be reasonable.

Consequently, most of these reserves, whether designated or not, are really “free” and available for current use wherever needed in the community, and it would be difficult to argue that the DRVC has been anything but ultra-conservative in its accumulation and management of these reserves. Every organization should have some reserves to protect against shortfalls and unexpected events, but the recommended reserve level for non-profit organizations equals one year of operating expenses, which in the case of the DRVC approximates an adjusted \$55 million (“defined operating expense”). So, all of the \$267.7 million of free cash reserves should be considered excessive except \$55 million.

In defense of its accumulation of excess cash reserves, the DRVC has used a variety of other arguments over the past several years to justify its accumulation of such large cash reserves. It’s interesting to observe the pattern of these arguments: As soon as one argument is effectively refuted, the DRVC develops a new “theory” to defend itself. Such arguments have included references to Canon Law, to the fact that the financial statements are audited, to aging parishes and schools, to possible unexpected events, to the authority of the Finance Council, to the need to have investment income for operational support and other factors. These arguments are very weak and are not supported by past practice or experience; nor do they meet any of the five criteria for reasonableness. Rather than list all of these arguments and why they are weak in the body of this report, I have summarized them in separate document available upon request, **“Diocesan Counterarguments One by One”**.

In late 2005, Bishop Murphy invited me to a meeting with him to discuss my analysis and views. The discussion was amicable and opened the door for me to ask more questions about Diocesan finances and to obtain a better understanding of them. At the Bishop's invitation, I followed-up that meeting with a letter containing 28 questions (40 questions including sub-parts). I did not receive an answer to one single question. During the meeting, Bishop Murphy presented his case as to why the Diocese could not spend its free cash reserves. Unfortunately, his case repeated past arguments and set forth a few new arguments, all of which were very weak. In addition, Bishop Murphy did not agree with my counterarguments to each of his arguments, and we were unable to find any middle ground either during the meeting or in subsequent correspondence. He ultimately discontinued communications with me.

In September, 2006, The Long Island Catholic published a two page article entitled, "Diocesan Reserves Explained". This article acknowledged the existence of \$200.4 million of unrestricted net assets, or "reserves", which basically confirmed my conclusion that the DRVC had at least \$187.6 million of free cash reserves in 2005 (before the auditor restatements noted earlier that increased the former amount by \$55.2 million and the latter amount by \$68.6 million). However, the article also attempted to justify the need for these reserves. Unfortunately, the justifications were more noteworthy for what they didn't say than what they did say and for more of the same misleading information, inaccuracies and half-truths used in the Diocesan counterarguments. My analysis of what the article said and didn't say can be found at **Attachment VII**.

Besides acknowledging that the DRVC had \$200.4 million of unrestricted net assets (before restatement), the article also acknowledged the existence of \$33.3 million (before restatement) of "discretionary funds", or undesignated unrestricted reserves, controlled by the Diocesan Administrative Offices. The article implied that the Bishop does not control the rest of the cash reserves (\$167.1 million). This is the latest argument being used by the DRVC to deflect criticism of its hoarding policies. I find this argument very weak since there is a history of intra-Diocesan transfers and other actions that suggest otherwise. For example, for many years the DRVC has been paying itself a "dividend" from Catholic Cemeteries, the "cash cow" of the Diocese, and the Bishop disbanded a financial advisory committee established by Catholic Cemeteries several years ago. Coincidentally, the Diocese of Brooklyn recently transferred a significant amount of its cemetery reserves to a pension fund for resigned priests after finding that such amount was more than actuarially-required for perpetual care. This, of course, suggests that the DRVC does have the ability to utilize the excess reserves maintained by its principal "cash cow", Catholic Cemeteries.

However, if we were to give the DRVC the benefit of the doubt and assume that there are limits to what the Bishop can dictate to some of these entities, then why are these entities accumulating excess reserves themselves? Have they succumbed to the same excess accumulation policies as the Diocese? They could certainly use these excess reserves, or at least the annual income thereon, on their own mission if they have the authority to do so. For example, the self-insurance funds could forego premium charges to all participating parishes and ministries for the next ten years to make up for many years of

over-charging the parishes and ministries. (Note: If the Bishop doesn't control these self-insurance funds, one wonders why he hasn't already made a claim against them on behalf of all his parishes and ministries requesting a refund of these over-charges, which far exceed what the actuaries have determined is necessary.). Catholic Cemeteries could increase the annual "dividend" it pays to the Administrative Offices (since it has already proven it has the ability to do so), thereby providing the Administrative Offices with resources it could use for other worthwhile causes, including an increased annual subsidy to Catholic Charities. Catholic Charities is now using 100% of its annual investment income (including realized gains), as it should, to fund critical needs instead of allowing its \$20 million reserve to continue growing each year by a portion or all of its investment income as it did in past years.

In summary, the argument that the Bishop does not effectively control most of the free cash reserves is very weak. But, even were we to assume some limitations on his control, there is no reason for the accumulation to be taking place in the other "non-controlled" Diocesan entities. On numerous occasions I have requested information on the legal structure of all Diocesan entities in order to make an independent determination concerning control. Needless to say, the DRVC has not responded to these requests.

Perhaps the DRVC and its Finance Council are concerned about the ultimate impact of the on-going sexual abuse litigation. If this is the underlying reason for the accumulation of reserves, I think it's a weak one. Unless such litigation is successful in suspending the statute of limitations through the courts (unlikely due to a decision by the highest New York court) or through legislation (also unlikely due to lack of State Senate support), its impact will be relatively minor given existing reserves and available insurance. Even were legislation passed or the Bishop were to unilaterally reach a settlement with the sexual abuse victims (as other dioceses have done), existing reserves are more than enough to pay the resulting claims based upon my analysis of known (and projected) victims and recent awards and settlements in other parts of the country. Consequently, doesn't it make sense for the DRVC to at least use the annual increase in free cash reserves (approximately \$5-12 million per year) to alleviate pressing community needs vs. increasing the amount possibly needed for litigants in the future?

In other parts of the country the dollar amount of victims' awards and settlements has become increasingly large. At some point in this process, we all become victims, i.e., thousands in need of Diocesan programs might face a loss of service and the parishes could be severely impacted were a one year "window" without limits opened for all past claims. I am not suggesting that any of us will ever be able to empathize with the victims or that any amount will compensate for the emotional trauma they have suffered. It is merely a plea for reason on all sides before everything we cherish is destroyed. In this respect, I personally am not in favor of a one year "window" for the filing of past claims unless it has some limits and/or is accompanied by a mechanism that balances the level of compensation with the other needs of the Diocese and community.

In any event, the DRVC should not use the sexual abuse litigation to justify the existence of excessive reserves while the number of people in need in our community continues to grow. Nor should the DRVC do anything less than exhaust every effort to negotiate a

fair and reasonable settlement with the victims as has been done in other parts of the country.

## **V. OTHER DEVELOPMENTS, INCLUDING THE INDEPENDENT VOLUNTEER ACCOUNTANTS AND CONSULTANTS GROUP REPORT**

In 2007, as noted earlier, a non-paid, independent Volunteer Accountants and Consultants Group (“VAC”) reviewed my report on 2005 DRVC finances and determined that my findings were “supportable” and my conclusions “reasonable”, including my findings and conclusions related to the discretionary “designations” (future uses) assigned by the DRVC to its unrestricted reserves. In fact, the VAC even went on to say that, “The Diocese of Rockville Centre appears to have no clear, specific and measurable policy regarding the designation (future uses) of these surplus funds.” It should be noted that the DRVC was invited to participate in this group but chose not to. Nor did it respond to the draft report in a complete or constructive fashion. The full report and further background exists on the Long Island Voice of the Faithful website ([www.votf-li.org](http://www.votf-li.org)).

There have been a number of other interesting developments during the past year related to DRVC free cash reserves and/or DRVC financial transparency in general:

1. **Article Published in the September 6, 2006 Edition of The Long Island Catholic Entitled “Diocesan Reserves Explained”**---As noted earlier, in late 2006 The Long Island Catholic published a two page article entitled, “Diocesan Reserves Explained”. This article acknowledged the existence of \$200.4 million (before restatement) of unrestricted net assets (“reserves”), which basically confirmed my 2005 analysis. However, the article also attempted to justify the need for these reserves. Unfortunately, the justifications were more noteworthy for what they didn’t say than what they did say and for providing more misleading information, inaccuracies and half-truths. My analysis of what the article said and didn’t say can be found at **Attachment VII**.
2. **Results of the 2006 Catholic Ministries Appeal**---The results of this Appeal continue to be weak despite the increased effort being put forth. (Note: The cost of the Appeal is no longer being deducted from results as it was in earlier years, making the trend even worse than it appears from the numbers presented below). Obviously, the sexual abuse scandal has had a major impact on the Appeal. However, other factors may have contributed as well. Were the Bishop to loosen his purse strings somewhat to help those in need, I believe parishioners would do the same thing and begin increasing their contributions to the CMA, thereby reversing this negative trend. Here are the audited results of the CMA for the past seven years:

2000 (8/31)	\$12.6 million
2001 (8/31)	\$12.8 million
2002 (12/31)	\$13.3 million
2003 (12/31)	\$ 9.3 million
2004 (12/31)	\$ 9.7 million
2005 (12/31)	Unknown
2006 (12/31)	\$10.4 million (Unaudited--See note below)

Note: In 2006, the Diocese once again changed the way it reports the results of the CMA in its audited financial statements, so it is impossible to determine the audited results for 2005 or 2006. The 2006 amount presented is the amount reported by Bishop Murphy in the January 31, 2007 edition of The Long Island Catholic.

These results should raise a big red flag for the Diocese---but apparently they don't. As a result, the Diocese is forced to either tap into its plentiful reserves or cut back on the services provided. Unfortunately, the Diocese tends to do the latter. That is why I personally no longer contribute to the CMA in favor of other high-impact human service organizations on LI with no excess reserves.

3. **The Maiello Sex Abuse Case**---As damaging as this case was to our Diocese from a public relations standpoint, it did almost no harm from a financial standpoint. The reason for this is threefold. First, there was a pre-trial agreement between the Diocese and the plaintiffs that limited the award to approximately \$5 million vs. the \$11.5 million awarded by the jury. Secondly, insurance will pay a substantial portion of this award. And, third, the amount actually paid by the DRVC will come from a special fund (Uninsured Perils Fund) established several years ago for just such contingencies. Although this fund is unrestricted, it was always considered restricted by me in my analysis and not included in free cash reserves. So, the case will have no impact on my free cash reserve calculation. It's interesting to note how the Diocese "spins" negative events such as this. In Bishop Murphy's letter to the Diocese concerning this case, he notes that "no monies will come from parishes or from donations of parishioners" to fund this award, but he fails to mention that the special Uninsured Perils Fund from which the award will be paid was, in fact, established from the donations of parishioners some time ago. In addition, the Diocesan spokesman, said that "the Diocese on three occasions offered what it believed was a fair monetary settlement" to the victims, but Michael Dowd, plaintiffs' attorney, adamantly denies that any offer was ever received.
4. **Indications of Change in Policy**---There have been a few positive signs that the DRVC has been loosening its purse strings in fiscal 2007. However, these signs are evident only anecdotally at this point and not from the audited financial statements (since the audited statements relate to a period prior to 2007). The signs include the following: (1) The DRVC has significantly reduced the premium it charges the parishes for property and casualty and health insurance in fiscal 2007. Presumably, the DRVC has finally recognized that it has a large amount of excess reserves in its self-insurance funds and is effectively drawing these reserves down somewhat via the reduced premium as I have urged it do in the past. Fueling this realization may also have been the restatement of \$13.4 million (net) of health insurance liabilities to net assets available for plan benefits as required by the new DRVC auditors. However, it will take many years for the excess to be completely drawn down, and it is unclear how long the DRVC plans to continue the reduced premium; (2) it is also evident that the DRVC is providing more grants to parishes needing major capital improvements and/or repairs; (3) the DRVC has been conducting a Diocesan-wide analysis of parish capital improvement and/or repair needs at no cost to the parishes; and (4) Bishop

Murphy recently announced the formation of a representative Diocesan Pastoral Council “to let the voices of the laity be heard in plans and hopes for the future of the Church”.

Despite these positive signs, I understand the DRVC is significantly cutting expenses and services in certain areas as revenues rise at a slower pace than expenses. Unfortunately, the DRVC is making these cutbacks when it could instead tap into its vast excess reserves. Let’s hope the new Diocesan Pastoral Council has some real clout so the “voices of the laity” can be heard on this matter.

One other possibly disturbing trend: The Administrative Offices made several transfers of free cash reserves during 2006 to other DRVC affiliated entities, which had the effect of reducing the FCR of the Administrative Offices while increasing the FCR of the other entities. These transfers all appeared to have a business purpose---they were made in the form of start-up capital (to Mission Assistance Corporation), payment of a payable (to Ecclesia Assurance Company, the captive insurance brokerage) and increased subsidies (to the High Schools). Nevertheless, I wonder whether there was a conscious effort by the Administrative Offices to reduce its FCR, which are very visible, by transferring as many of them as possible to other entities where they are less visible. Perhaps DRVC motives are pure, and is it merely trying to better capitalize these other entities---not trying to hide its most visible excess reserves. Time will tell.

## **VI. CONCLUSIONS**

Given the available evidence, it is apparent that the cash reserves maintained by the DRVC are very large and excessive both in absolute terms and in relation to industry standards. In addition, such reserves continue to grow despite negative demographic, economic and giving trends and despite the growing number of people in need on LI. Given the fact that the DRVC has \$267.7 million of “free cash reserves” (4.9 times annual defined operating expenses compared to an industry standard of 1 time operating expenses); has \$212.7 million more free cash reserves than the 1 year industry standard recommends; has total unrestricted cash and securities equal to \$293.9 million; has unrestricted net assets that exceed the maximum allowed under a Better Business Bureau standard by \$131.5 million; has unrestricted cash and marketable securities that exceed total liabilities by \$139.2 million; has a current ratio of 7.8 and current assets exceeding current liabilities by \$319.3 million; has virtually no long-term debt; and has \$70.9 of undesignated cash reserves, it is difficult to reach any conclusion other than the following:

**1. The DRVC has accumulated far more cash reserves than it needs.** The \$267.7 million of free cash reserves is not only excessive by any measure but also represents an increase in free cash reserves of \$11.5 million from the prior year. Thus, the DRVC continues to accumulate more excess reserves despite the excessive amount already on hand, despite growing community needs and despite pleas of poverty by the DRVC itself.

**2. The DRVC has been far more aggressive in accumulating cash reserves and “designating” them for future use than current human needs within the Diocese dictate.** The DRVC has been “over-designating” and/or unreasonably conserving its unrestricted net assets for vague future uses, contingencies and emergencies, thereby preventing their use for urgent, specifically identifiable current needs in the community. Parishioners and other contributors of these funds certainly did not intend for any portion of them to be set aside as a “quasi-endowment fund” or reserved for future general use, particularly while balanced budget protocols are simultaneously being imposed on the various Diocesan ministries. In fact, an argument could be made that the DRVC has deceived parishioners by “banking” collections, assessments and donations that parishioners had a right to expect were being used for current, pressing needs.

**3. The continued accumulation of free cash reserves suggests that the DRVC lacks either the will or an effective mechanism to balance fiscal conservatism with growing human needs on Long Island, an important focus of its spiritual and humanitarian mission.** The Diocesan Finance Council, whose mission is the safeguarding of assets, has a natural tendency to encourage the accumulation of as many reserves as possible. This tendency needs to be controlled in some fashion by the DRVC and balanced against the spiritual and humanitarian mission of the Church.

What is so surprising to me about DRVC accumulation policies is that the DRVC effectively has the ability to “tax” its parishes, ministries and parishioners were it ever to be short of funds. So, it has every reason to follow Christian stewardship principles and virtually no reason to accumulate excess reserves beyond a minimal amount suggested by industry standards.

The purpose of my analysis is not to impugn the integrity of the Bishop, his Diocesan Finance Council or any of his other financial advisors. Rather, the purpose is to generate more thought and discussion on what amount of free cash reserves is advisable, what amount is consistent with Christian principles and what is the appropriate mechanism to assure a fair and reasonable balance between current and future needs.

In the interest of financial transparency and accountability endorsed by the U.S. Conference of Catholic Bishops, the DRVC should at least address the following questions, which all Long Island Catholics have a right to know the answers to:

**1. Why doesn't the DRVC have an effective mechanism in place to balance current human needs with future contingent needs? Are the hungry, homeless, those without healthcare, jobless, youth in foster care, homebound, nursing-home elderly, those suffering from addictions and/or in need of counseling, youth in distress, those unable to afford housing, etc. being regarded with equal importance as the need to accumulate more reserves? Are foundational Christian principles really being followed in the stewardship of Diocesan reserves?**

**2. If, as the Chairman of the Diocesan Finance Council admitted several years ago, cash reserves are “adequate,” shouldn't any future increases in**

reserves be used for current needs vs. accumulating even more reserves, particularly given the spiritual and humanitarian mission of the Church?

**3. In times of critical need such as we face today, wouldn't it even make sense to dip into these reserves a little, replenishing them later during better times, vs. cutting back and/or continuing to impose balanced budget protocols on human service programs?**

**4. Does the DRVC have any reasonable guidelines to determine when its reserves become excessive and/or when they can be used for high priority human needs? What are they?**

**5. Wouldn't it make sense to establish a representative Diocesan Finance Council as proposed by the LIVOTF and petitioned by 6,599 parishioners in 2006 (see proposal at [www.votf-li.org](http://www.votf-li.org))? Or, wouldn't it make sense to establish some other mechanism to assure that the mission of the Diocesan Finance Council (to safeguard assets) and ultra-conservative fiscal management policies of the Diocesan hierarchy are fairly balanced with the humanitarian mission of the Church? (Note: I don't think the Diocesan Pastoral Council recently announced by Bishop Murphy will be able to accomplish this.)**

**6. Why doesn't the DRVC publish combined (consolidated) financial statements together with a meaningful discussion and analysis thereof to make its financial condition a lot clearer?**

**7. If \$267.7 million of free cash reserves is not enough, then HOW MUCH IS ENOUGH?**

In closing, I would like to quote the Winter/Spring 2005 Catholic Charities Newsletter, which stated that early in the history of the DRVC, "Bishop Kellenberg clearly showed the region what kind of Church the Catholic Church on Long Island would be: A caring Church, that seeks out the isolated and discarded and calls them its very own." With \$267.7 million of free cash reserves, can the DRVC still make this claim today? I think not.

**It cost Catholic Charities \$33.2 million to serve 57,890 people in need in 2006---a cost of only \$574 per person served. Another \$10 million allocated from the huge Diocesan reserves would allow Catholic Charities to serve an additional 17,422 people per year at that rate. Isn't that compelling enough? If not, consider this: The Diocese of Paterson (New Jersey) is less than half the size of our Diocese, but its budget for Catholic Charities is 50% greater.**

The Catholic Church hierarchy talks a lot these days about the need for a "preferential option for the poor", or a mandate to eliminate poverty throughout the world. Is that our Diocesan preferential option or is it to accumulate more cash reserves?

## **VII. OTHER DOCUMENTS AVAILABLE UPON REQUEST**

- I. MY RESPONSE TO THE DRVC FINANCE COUNCIL CRITICISM OF MY ANALYSIS OF 8/31/02 "FREE CASH RESERVES"**
- II. ACTUAL CALCULATION OF "DEFINED OPERATING EXPENSES" 2003-2006**
- III. SELECT FINANCIAL METRICS FROM 2003-2005 FINANCIAL STATEMENTS**
- IV. PRIOR YEAR ANALYSES 2003-2005**
- V. THE LONG ISLAND CATHOLIC SEPTEMBER, 2006 ARTICLE, "DIOCESAN RESERVES EXPLAINED"**
- VI. DIOCESAN COUNTERARGUMENTS ONE BY ONE**

## **VIII. ATTACHMENTS**

## ATTACHMENT I: CALCULATION OF DRVC "FREE CASH RESERVES" AS OF 8/31/06 – DIRECT METHOD

(Amounts In Thousands)

ITEM	ADMIN OFFICE	MISSION ASSIST.	CATH. CHAR.	SELF INS. PROGRM	HEALTH INS. PRG.	CATH. CEMETER	TOTAL	OTHER ENTITIES	GRAND TOTAL
Cash and marketable securities	\$67,073	\$4,688	\$21,998	\$80,468	\$24,585	\$114,634	\$313,446	\$385,539	\$698,985
Less:									
Deposit (DLA)/ custodial liability	(10,044)	-	-	-	-		(10,044)	(370,048)	(380,092)
Restricted invests./net assets	(10,457)	-	(1,658)	(8,870)	-	(11)	(20,996)	(3,950)	(24,946)
Unrestricted cash and marketable securities	\$46,572	\$4,688	\$20,340	\$71,598	\$24,585	\$114,623	\$282,406	\$11,541	\$293,947
Less: "Net liabilities" of entities	-	-	-	(23,181)	(1,260)	-	(24,441)	(1,785)	(26,226)
<b>"FREE CASH RESERVES"</b>	<b>\$46,572</b>	<b>\$4,688</b>	<b>\$20,340</b>	<b>\$48,417</b>	<b>\$23,325</b>	<b>\$114,623</b>	<b>\$257,965</b>	<b>\$9,756</b>	<b>\$267,721</b>
Undesignated portion	\$35,220	\$0	\$288	\$0	\$0	\$29,461	\$64,969	\$5,869	\$70,838
Designated for future use	11,352	4,688	20,052	48,417	23,325	85,162	192,996	3,887	196,883
<b>Total "FREE CASH RESERVES"</b>	<b>\$46,572</b>	<b>\$4,688</b>	<b>\$20,340</b>	<b>\$48,417</b>	<b>\$23,325</b>	<b>\$114,623</b>	<b>\$257,965</b>	<b>\$9,756</b>	<b>\$267,721</b>

**NOTE 1:** The entities separately named in the above calculation all have unrestricted net assets in excess of \$4 million. "Other Entities" consist of Telecare; Catholic Press Association; the Diocesan High Schools; Seminary of the Immaculate Conception; Tomorrow's Hope Foundation; Propagation of the Faith & Mission Office; Diocesan Service, Ecclesia Assurance Company and Unitas Investment Fund. These entities were included in this calculation as a group because individually they are all immaterial with unrestricted net assets of less than \$4 million each. Catholic Charities, Propagation of the Faith & Mission Office, Tomorrow's Hope and Ecclesia all have 12/31 Year-ends. The High Schools have a 6/30 year-end.

**NOTE 2:** The financial statements published by the DRVC do not include the parishes, parish schools and the Catholic Health System. Consequently, the above calculation does not include amounts for these entities.

**NOTE 3:** In 2003, cash on deposit with the DRVC ("Deposit and Loan Account" or "DLA") was included in the Administrative Office cash amounts. In 2004, such amount was transferred to a newly-created entity, Unitas Investment Fund, which now invests cash deposited with the DRVC by parishes and ministries. Unitas is included with "Other Entities" above since its net assets equal -0- (a liability to the parishes/ministries offsets the related cash on deposit). This has no effect on "free cash reserves" in either year.

**NOTE 4:** "Net liabilities" include the unrestricted \$8.9 million Uninsured Perils Fund because it is assumed that such Fund will be required for abuse claims, including the recent \$5 million award (Maiello Case). Consequently, no portion of the Uninsured Perils Fund is included in the "free cash reserves" calculated above.

## ATTACHMENT I: CALCULATION OF DRVC "FREE CASH RESERVES" AS OF 8/31/06 – INDIRECT METHOD

(Amounts In Thousands of \$)

ITEM	ADMIN OFFICE	MISSION ASSIST.	CATH. CHAR.	SELF INS. PROGRM	HEALTH INS. PRG.	CATH. CEMETER	TOTAL	OTHER ENTITIES	GRAND TOTAL
Cash and marketable securities	\$67,073	\$4,688	\$21,998	\$80,468	\$24,585	\$114,634	\$313,446	\$385,539	\$698,985
Less:									
Deposit (DLA)/custodial liability	(10,044)	-	-	-	-	-	(10,044)	(370,048)	(380,092)
Restricted invests./net assets	(10,457)	-	(1,658)	(8,870)	-	(11)	(20,996)	(3,950)	(24,946)
Unrestricted cash and marketable securities	\$46,572	\$4,688	\$20,340	\$71,598	\$24,585	\$114,623	\$282,406	\$11,541	\$293,947
Unrestricted net assets	\$47,572	\$6,349	\$24,828	\$48,417	\$23,325	\$125,714	\$276,205	\$12,238	\$288,443
<b>"Free cash reserves" = The lesser of above two amounts</b>	<b>\$46,572</b>	<b>\$4,688</b>	<b>\$20,340</b>	<b>\$48,417</b>	<b>\$23,325</b>	<b>\$114,623</b>	<b>\$257,965</b>	<b>\$9,756</b>	<b>\$267,721</b>
"Undesignated" portion	\$35,220	\$0	\$288	\$0	\$0	\$29,461	\$64,969	\$5,869	\$70,838
Designated for future use	11,352	4,688	20,052	48,417	23,325	85,162	\$192,996	3,887	196,883
<b>Total "free cash reserves"</b>	<b>\$46,572</b>	<b>\$4,688</b>	<b>\$20,340</b>	<b>\$48,417</b>	<b>\$23,325</b>	<b>\$114,623</b>	<b>\$257,965</b>	<b>\$9,756</b>	<b>\$267,721</b>

**NOTE 1:** The entities separately named in the above calculation all have unrestricted net assets in excess of \$4 million. "Other Entities" consist of Telecare; Catholic Press Association; the Diocesan High Schools; Seminary of the Immaculate Conception; Tomorrow's Hope Foundation; Propagation of the Faith & Mission Office; Diocesan Service, Inc.; Ecclesia Assurance Company and Unitas Investment Investment Fund, Inc. These entities were included in this calculation as a group because individually they are all immaterial with unrestricted net assets of less than \$4 million. Catholic Charities, POTF/Mission Office, Tomorrow's Hope, Ecclesia have a 12/31 year-end; High Schools have a 6/30 year-end.

**NOTE 2:** The financial statements published by the DRVC do not include the parishes, parish schools and the Catholic Health System. Consequently, the above calculation does not include amounts for these entities.

**NOTE 3:** In 2003, cash on deposit with the DRVC ("Deposit and Loan Account" or "DLA") was included in the Administrative Office cash amounts. In 2004, such amount was transferred to a newly-created entity, Unitas Investment Fund, which now invests all cash deposited with the DRVC by the parishes and ministries. Unitas is included with "Other Entities" above since its net assets equal -0- (a liability to the parishes/ministries offsets the related cash on deposit). This has no effect on "free cash reserves" in any year.

**NOTE 4:** The Protected Self-Insurance Fund unrestricted net assets of \$48.4 million excludes the \$8.9 million Uninsured Perils Fund because it is assumed that such fund will be required for abuse claims, including a recent \$5 million award (Maiello Case). Consequently, no portion of the Uninsured Perils Fund is included in the "free cash reserves" calculated above.

## ATTACHMENT II: KEY CASH RESERVE AMOUNTS/RATIOS/INDUSTRY COMPARISONS

(\$ AMOUNTS IN MILLIONS)	2003	2004	2005	2006
	<u>RESTATED---SEE NOTE 2</u>			
A. "Free cash reserves" (see definition at Attachment V)	\$244.5	\$251.0	\$256.2	\$267.7
B. Increase in "free cash reserves" from prior year	\$12.2	\$6.5	\$5.2	\$11.5
C. Number of years of operating expenses available in the form of "free cash cash reserves" using defined operating expenses per P. and Note 1 below	4.4	4.6	4.7	4.9
D. Industry standard for maximum number of years of operating expenses available in the form of cash reserves	1.0	1.0	1.0	1.0
E. Amount of "free cash reserves" in excess 1 year standard	\$189.5	\$196.0	\$201.2	\$212.7
F. Unrestricted net assets	\$278.8	\$286.1	\$289.2	\$296.5
G. BBB standard for maximum number of years of operating expenses allowed in the form of unrestricted net assets	3.0	3.0	3.0	3.0
H. Amount/years of unrestricted net assets in excess of BBB std.				
Amount (F. less 3.0 X P.)	\$113.8	\$121.1	\$124.2	\$131.5
Years (F. divided by P. minus 3 years)	2.1	2.2	2.3	2.4
I. Total unrestricted cash less total liabilities (unrestricted cash remaining after payment of all liabilities---N. minus O.)	\$158.5	\$153.1	\$134.6	\$139.2
J. Current ratio (Q. divided by R.)	NA	NA	9.1	7.8
K. Current ratio industry standard	2.0	2.0	2.0	2.0
L. Amount/ratio in excess of current ratio industry standard				
Amount (Q. minus 2.0 X R.)	NA	NA	\$284.1	\$272.4
Ratio (J. minus K.)	NA	NA	7.1	5.8
M. Debt to equity ratio (S. divided by T.)	NA	NA	3.8%	4.6%
<b><u>ADDITIONAL FINANCIAL INFORMATION USED IN CALCULATION OF ABOVE AMOUNTS:</u></b>				
N. Total unrestricted cash and marketable securities	\$279.9	\$288.3	\$282.8	\$293.9
O. Total liabilities	\$121.4	\$135.2	\$148.2	\$154.7
P. Defined operating expenses (see Note 1 below)	\$55.0	\$55.0	\$55.0	\$55.0
Q. Current assets	NA	NA	\$363.9	\$366.2
R. Current liabilities	NA	NA	\$39.9	\$46.9
S. Long-term debt	NA	NA	\$11.5	\$14.3
T. Net assets	NA	NA	\$304.3	\$312.8

**NOTE 1:** See Attachment VI for a definition of "Defined Operating Expenses". The actual calculation is available upon request. Although the actual calculation results in a different amount each year, a constant amount of \$55 million is used for all years to insure that the "Key Ratios" are not distorted by annual variations in the amount of "Defined Operating Expenses" or by the inexactness of the calculation. The actual amounts calculated in 2003-2006 were \$37.6 million, \$42.4 million, \$51.3 million and \$52.6 million, respectively.

**NOTE 2:** New auditors in 2006 required the DRVC to make two restatements of prior year financial statements, which had the effect of increasing free cash reserves and unrestricted net assets by \$68.6 million. A third restatement resulting from the adoption of a new accounting pronouncement resulted in a decrease in unrestricted net assets of \$13.4 million but had no impact on free cash reserves. All years and appropriate amounts above have been restated by similar amounts to maintain their comparability. For more details on these restatements see Attachment III.

**ATTACHMENT III: SUMMARY OF MAJOR CHANGES REFLECTED IN THE DRVC FISCAL 2006 FINANCIAL STATEMENTS** (Also see Attachment VIII---  
Select Financial Metrics for 2006)

1. Together with its financial statements, the DRVC published (on its website) a discussion of the results of each of its affiliated entities for the first time in 2006. This is a significant improvement from the past when no such discussion was provided. However, the discussion does not discuss combined (consolidated) DRVC results, which makes it difficult to understand what's really happening in the Diocese as a whole. I continue to recommend that the DRVC publish combined results with a complete discussion and analysis thereof. The summary of major changes provided below focuses on such combined results, which I have derived from my own combination thereof. However, such combination is difficult given the limited information provided by the DRVC, particularly on inter-Diocesan transactions and balances, and, therefore, the information presented could be misleading or inaccurate.
2. The overall quality and quantity of disclosures in the financial statements improved again in 2006. However, three auditors are now being employed vs. two in the past, which will make it more difficult in the future to achieve the objective noted in 1. above (combined financial statements).
3. The new auditors required two restatements in 2006 which increased the amount of free cash reserves by 68.6 million. Catholic Cemeteries was required to reclassify \$55.2 million of permanently restricted net assets (all in the form of cash reserves) to unrestricted net assets. Based upon the mechanics of my free cash reserve calculations, this resulted in all \$55.2 million being added to free cash reserves. More importantly, this suggests that there really is a great deal of excess and redundant reserves at Catholic Cemeteries as I have been arguing for the past four years (see Attachment IV for a more detailed discussion of the Catholic Cemeteries FCR). The other required restatement involved the reclassification of \$13.4 million of Health Insurance Program liabilities into net assets available for benefits. In other words, such amount is not really a liability, and the related cash reserves are generally available to pay future claims of the participants. Thus, the \$13.4 million of related cash reserves are free cash reserves.
4. The Administrative Offices had one more restatement related to adoption of a new accounting pronouncement, which decreased net assets by \$13.4 million but had no effect upon free cash reserves. This restatement recorded the net future asbestos abatement cost related to certain Diocesan buildings. It had no impact on my free cash reserve calculation because the non-cash assets of the Administrative Offices still exceed its liabilities even after adding this liability.

5. As of the date of this report, the DRVC had still not published its final two audited financial statements 18 months after its fiscal year-end of August 31, 2006---The Self-Protected Insurance Program and Propagation of the Faith/Mission Office
6. "Free cash reserves" increased \$11.5 million in 2006 to \$267.7 million from a restated \$256.2 million in 2005. This increase compares to a restated \$5.2 million, \$6.5 million and \$12.2 million increase in 2005-2003, respectively. It continues the pattern of increases in the last four years of \$5-12 million per year.
7. Total unrestricted cash minus all recorded liabilities equaled \$139.2 million at the end of 2006 (compared to \$134.6 million at the end of 2005). In other words, the DRVC could pay-off all its recorded liabilities and still be left with all of its tangible assets **and** \$139.2 million of unrestricted cash.
8. Net assets increased by \$11.5 million in 2006 to \$312.8 million. In other words, the Diocese once again had an operating surplus in 2006 (of \$11.5 million). In 2005 net assets increased by \$5.5 million.
9. Unrestricted net assets increased by a restated \$3.1 million in 2006 and now equal \$296.5 million, which is equivalent to 5.4 years of defined operating expenses vs. the Better Business Bureau Wise Giving Alliance maximum charitable organization standard of 3 years. In other words, the DRVC unrestricted net assets exceeded the maximum allowed per the standard by 2.4 years or \$131.5 million (compared to 2.3 years or \$124.2 million in 2005). As a result, the Alliance discourages donors from giving to the DRVC.
10. Total revenues increased by \$17.6 million to 232.1 million, and total expenses increased by \$14.2 million to \$223.2 million in 2006. This compares to increases in revenues and expenses of \$29.6 million and \$33.6 million, respectively, in 2005. However, these amounts are before inter-Diocesan eliminations, so caution should be used in reaching any conclusions. Expense increases were evident across all Diocesan entities although these increases were, for the most part, offset by increased third party reimbursements, assessments, fees, tuition and other revenue.
11. The most significant increases in revenue and expense occurred at the Administrative Offices where revenues increased by \$8.8 million and expenses increased by \$17 million (before the cumulative effect of an accounting change). However, \$4.4 million of the revenue increase and a comparable amount of the expense increase appears to be the result of the change in the way the Catholic Ministries Appeal was reported. In addition, \$5.4 million and \$2.7 million, respectively, of the expense increase resulted from the first-time funding of the Mission Assistance Corporation and an increase in the allowance

for bad debts to 93% of the related parish receivables. The Health Insurance Program had a significant decrease in expenses (\$3.4 million) related principally to a prior year large bad debt expense as well as a lower obligation to plan participants.

12. "Defined operating expenses" used to compute many of the ratios in this report increased to \$52.6 million in 2006 from \$51.3, \$42.4 million and \$37.6 million, in 2005, 2004 and 2003, respectively. However, \$55 million was used in all years to calculate all ratios in order to eliminate fluctuations caused by annual variances in expenses and the inexactness of the calculation. Note, however, that "Defined operating expenses" have increased annually, primarily reflecting greater self-insurance claims and losses.
13. The Health Insurance Program and Catholic Cemeteries had the largest operating surpluses during 2006 (excluding the Mission Assistance Corporation surplus resulting from the transfer of capital from the Administrative Offices). The Health Insurance surplus equaled \$4.4 million. Catholic Cemeteries' surplus equaled \$4.3 million (down from \$9.2 million in 2005) after paying a \$2.2 million dividend ("contribution") to the Administrative Offices. Catholic Cemeteries is the "cash cow" of the DRVC and has had a significant surplus each of the past four years. Only a few insignificant operating deficits occurred (after including grants provided by the Administrative Offices). As noted above, the Administrative Offices basically broke even after excluding the transfer of capital to the Mission Assistance Corporation and the additional bad debt expense (non-cash) provided on parish loan receivables.
14. The Unitas Investment Fund, an affiliated entity, manages most of the Diocesan investment funds and cash reserves on a pooled basis, including funds deposited by the various parishes and ministries. Unitas has historically paid an administrative and "mission fee" to the Administrative Offices. With the establishment of the Mission Assistance Corporation in 2006, such mission fee is now being paid to it. The mission fee approximated \$.7 million in 2006 and \$1 million in 2005. It is not related to any specific services performed and is another creative way for the DRVC to pay itself a "dividend" at the expense of the parishes, schools and ministries unless the MAC actually uses the fee for its mission, parish assistance.
15. See **Attachment VIII---Select Financial Metrics for 2006** for additional key financial data on an entity-by-entity and combined basis.

**ATTACHMENT IV: MAJOR COMPONENTS OF FREE CASH RESERVES**  
**("FCR") AS OF AUGUST 31, 2006**

Summary of Components (In millions of dollars)

Entity	Designated	Undesignated	Total
Administrative Offices	\$11.4	\$35.2	\$46.6
Mission Assistance Corporation	4.7	0	4.7
Protected Self Insurance Program	48.4	0	48.4
Health Insurance Program	23.3	0	23.3
Catholic Cemeteries	85.2	29.4	114.6
Catholic Charities	20.0	.3	20.3
Other Insignificant Entities	3.9	5.9	9.8
<b>Total</b>	<b>\$196.9</b>	<b>70.8</b>	<b>\$267.7</b>

Administrative Offices: FCR = \$46.6 million (\$54.4 million in 2005)

The 2006 decrease in FCR resulted primarily from the transfer of \$5.4 million in reserves to a newly-established affiliated entity, Mission Assistance Corporation, whose purpose is to administer loans to parishes in need and occasionally make grants to such parishes when they are "unable to fulfill the mission of the Church". This role was historically fulfilled by the Administrative Offices. The rest of the decrease in FCR resulted from an operating loss, which is consistent with past operating losses of the Administrative Offices albeit somewhat larger. Generally, the Administrative Offices operate at a loss, which is more than offset by profits at the other affiliated entities.

Of the \$46.6 million in FCR, \$35.2 million is undesignated and \$11.4 million is designated for specific purposes. Whether designated or undesignated, all of the \$46.6 million is unrestricted and most of it constitutes what the DRVC admits is a "quasi-endowment fund" created from parishioner contributions and assessments over the years. It is now "used to produce investment income in support of the diocesan budget." Thus, it is a free cash reserve although use of any portion of such fund would result in less investment income to support current operations. Besides parish assessments and other contributions, this endowment fund has been built-up using a 1% assessment on certain parish/ministry funds deposited with the Diocese; such fee was reduced in 2005 when the deposited funds were transferred and managed by the Unitas Investment Fund, another affiliated entity, but the fee still approximates \$1 million per year in the form of a "mission fee" paid by Unitas to the newly-established Mission Assistance Corporation.

As can be seen, most of the \$46.6 million is undesignated as to future use since the DRVC intends to maintain its "quasi-endowment fund" to support operations currently with the related investment income. The fund was principally built-up from the weekly assessments on parish Sunday collections---a policy which is very problematic since it is

unlikely that parishioners and other contributors ever intended their contributions to be accumulated in any sort of fund vs. being used currently to support to the mission of the Church.

The Administrative Offices adopted a new accounting principle in 2006, which had the effect of reducing its net assets by \$13.4 million. However, this change had no effect on free cash reserves.

*Mission Assistance Corporation: FCR = \$4.7 million (-0- in 2005)*

As noted under Administrative Offices, Mission Assistance Corporation was formed in 2006 to administer loans to parishes in need and occasionally make grants to such parishes when they are “unable to fulfill the mission of the Church”. This role was historically fulfilled by the Administrative Offices. The Offices transferred \$5.4 million from its excess funds to provide MAC with the funding it needed to fulfill this purpose.

The \$4.7 million of FCR is all designated for this purpose of parish assistance. However, only \$1.5 million in loans and no grants were made during fiscal 2006. In addition, historically the rate of parish assistance has been very low. For example, loans receivable from parishes actually decreased in 2005 by \$3.5 million, and parish grants were a nominal \$.5 million. In the four years prior to 2005, loans extended to parishes averaged about \$3 million per year and were much less than that most of the time. Consequently, the establishment of the MAC and transfer to it of \$5.4 million in excess funds provides no assurance that the money will be used for its “designated” purpose.

*Protected Self Insurance Fund: FCR = \$48.4 million (\$48.4 million in 2005)*

The Protected Self Insurance Fund is one of two Diocesan entities that have not yet published audited financial statements for 2006. However, due to the “pass-through” nature of this entity, it’s unlikely that the results once published will materially affect the combined DRVC results or the amount of FCR. The Fund is assumed to have operated at break-even during 2006, and FCR are assumed to remain the same between 2005 and 2006.

The \$48.4 million of FCR are over and above what the independent actuary and independent auditor say is necessary for reported and incurred-but-not-reported claims throughout the diocese (based upon past experience and other factors). Although the Diocesan Finance Council apparently believes it is wise to keep something extra in reserve to protect against unexpected events, the additional \$48.4 million excess reserve is equivalent to 84% of the existing actuarially-determined reserve for all past unpaid claims (90% in 2004). This is far in excess of the 15-20% that most financial managers might want to keep as “something extra”. In addition, I have excluded the separate \$8.1 million Uninsured Perils Fund (maintained for sexual abuse expenses and claims) from

the \$48.4 million excess reserve amount since this will probably be needed and should not be considered “free” or excessive.

Health Insurance Program: FCR = \$23.3 million (\$18.1 million in 2005, As Restated)

The \$23.3 million in FCR is all designated for future health claims. However, 100% of this amount is over and above what the administrator of the plan has determined is necessary for reported and incurred-but-not-reported claims throughout the Diocese (based upon past experience and other factors). Thus, it is all deemed to be free and excessive. The prior year amount was restated to reflect the finding of the new auditors that \$13.4 million was not actually a liability to plan participants but generally available for future claims. This increased the Health Insurance Program and combined DRVC FCR in 2006 by \$13.4 million. After restatement of the prior year FCR for this change, the comparative increase in FCR in 2006 equaled \$5.2 million (\$18.1 million to \$23.3 million), which appears to be the result of continued over-assessing of affiliated entities plus investment income earned on the excess funds.

Catholic Cemeteries: FCR = \$114.6 million (\$109.9 million in 2005, As Restated)

The new auditors required the reclassification of \$55.2 million of permanently restricted net assets to unrestricted net assets in 2006. This had the effect of increasing FCR by the same amount (for both Catholic Cemeteries and the DRVC on a combined basis) and supports my past contention that many of Catholic Cemeteries’ cash reserves are not required for future obligations. 2005 FCR were restated to reflect this reclassification, and on a comparable basis Catholic Cemeteries FCR increased \$4.7 million in 2006 (\$109.9 million to \$114.6 million).

The total amount of Cemeteries free cash reserves consists of \$29.5 million of unrestricted, undesignated free cash reserves and \$85.2 million of unrestricted reserves designated for the “future care of mausoleums”, “future maintenance and operation of Holy Rood Cemetery after its primary revenue producing operation has ceased” and future “general maintenance and improvements of the cemetery”. Both amounts appear excessive based upon the historical level of maintenance revenues and operating expenses and/or redundant based upon the description of the intended uses. Finally, the DRVC has already purchased property in Old Westbury for a new cemetery, so it is unreasonable to assume the funds are needed for that purpose beyond the necessary improvements to such property, which obviously won’t cost nearly as much as the unrestricted, undesignated reserves.

Perhaps the existence of such excess reserves explains why Catholic Cemeteries is able to provide a significant annual subsidy to the DRVC Administrative Offices (\$2.2 million in 2006 and \$18.7 million since 1961). However, not enough information is available to precisely determine the excess amount. Unfortunately, my requests for more information to determine the exact amount of the excess have gone unanswered although the DRVC

did indicate last year that an “analysis of these funds is being updated”. Presumably, such estimate will determine the discounted cost of providing the above-mentioned maintenance (mausoleums, grave sites, facilities and common grounds) in perpetuity. That amount represents a real liability for Catholic Cemeteries absent any continuing sources of net revenues, and such amount should be considered unavailable as a free cash reserve. Thus, although my analysis considers 100% of Catholic Cemeteries unrestricted cash as free and available, some significant portion of it, perhaps as much as 50% or more, really represents a liability to provide continuing maintenance in perpetuity assuming no continuing sources of net revenues. However, that still leaves a substantial portion of the unrestricted cash reserves as free and available for other uses within the Diocese.

From an operating standpoint Catholic Cemeteries continues to be the “cash cow” of the DRVC operating entities, increasing its net assets by \$4.3 million and FCR by \$4.7 million during 2006. These increases are consistent with prior year increases and are after paying the \$2.2 million subsidy to the Administrative Offices noted above. The DRVC constantly points out that Holy Rood is close to capacity (when it will no longer be able to sell burial rights), but somehow it manages to continue producing profits. In addition, Catholic Cemeteries appears not to have a separate, independent board, and its advisory council was terminated by the Bishop a number of years ago. So, arguing that the DRVC has no access to these excess funds is a shallow argument.

Catholic Charities: FCR = \$20.3 million (\$20.1 million in 2005)

Although \$20 million of this amount is designated for future use, no information has been presented in the financial statements to evaluate such designation. The original source of this reserve was a bequest, but the restrictions on the bequest have lapsed, and the reserve has grown by over 100% since the bequest was made. Based upon correspondence with Catholic Charities over the past two years, it’s apparent to me that Catholic Charities is concerned about flattening revenue sources and rising expenses. That may explain why it does not wish to draw down on the reserve and why it continues to have a balanced budget protocol imposed on it (by itself, its Board and/or the Administrative Offices).

To its credit, Catholic Charities used all of its investment income and even dipped into its free cash reserves by \$.8 million in 2005 to fund its programs. In 2006, its FCR increased by only \$.2 million. It’s unclear whether or not this was the result of a policy decision or lower investment income and increased expenses in 2005 and 2006. In any event, the reserve is certainly large enough, so it’s time for Catholic Charities to limit any further growth in the reserve as it appears to be doing the last two years. Given the great mission that Catholic Charities has, it’s a shame that the DRVC doesn’t reallocate some of its other reserves to Catholic Charities to allow it to expand its services to the growing number in need on LI. By way of example, the Diocese of Paterson (New Jersey) is less than half the size of the DRVC, but its Catholic Charities budget is 50% greater.

All Other Diocesan Entities Combined: FCR = \$9.8 million (\$5.2 million in 2005)

Of the \$9.8 million of free cash reserves held by all other Diocesan entities (each with net assets less than \$4 million), \$5.9 million is “undesignated” as to future use.

## **ATTACHMENT V: SPECIFIC METHODOLOGY USED TO CALCULATE DRVC “FREE CASH RESERVES”**

### *General Description*

The calculation of DRVC “free cash reserves” has been accomplished in the following manner (referred to as the “Direct Method” in the body of the report and in Attachment I):

- Cash and marketable securities of all DRVC entities (combined)**
- Less: All restricted cash and marketable securities**
- Less: Assets held in custody for other entities, including the “Deposit and Loan Account” and Unitas Investment Fund deposit liabilities**
- Less: Other restricted assets (which might contain some cash and/or securities)**
- Less: “Net liabilities” (if a positive amount) of individual entities (liabilities less non-cash assets); also deduct the “Uninsured Perils Fund”, which although unrestricted is assumed needed for the sexual abuse claims and related costs**
- Equals: Free Cash Reserves (“FCR”)**

This calculation is intended to derive the amount of unrestricted cash and marketable securities not needed in operations and, therefore, available for general use. The purpose of deducting “net liabilities” in the second to last step is to reduce the amount of unrestricted cash and securities by an amount that might theoretically be needed to pay liabilities exceeding non-cash assets.

### *Detailed Description of the “Direct Method”*

**ADD:** All cash, cash equivalents, investments and marketable securities of all DRVC entities

**LESS:** All restricted cash and investments included in the above amount

**LESS:** Assets held in custody for other entities, such as the “Deposit and Loan Account” and Unitas Investment Fund deposit liabilities. These assets are included in the total amount of cash calculated above but are owed to other entities. Therefore, they are not available for use in operations and must be eliminated

**LESS:** Any other restricted net assets, which are not clearly identified and might consist of restricted cash and/or securities (Reason for this step: The identity of a small amount of certain restricted net assets is not clear. Since they might consist of restricted cash and/or securities, it is assumed in order to be conservative that they do. Under this

assumption they must be deducted in the calculation of “Free Cash Reserves” just as other restricted cash and securities are deducted)

**RESULT:** Unrestricted cash, cash equivalents, investments and marketable securities

**FINAL STEP:** Deduct the “net liability” that any DRVC entity has from the **RESULT** above. This ensures that “Free Cash Reserves” do not include any amount theoretically needed to pay liabilities exceeding non-cash assets at any DRVC operating entity. Also deduct the “Uninsured Perils Fund”, which was established via assessments on the parishes over a period of time in the late 80’s and 90’s. Although the Uninsured Perils Fund is an unrestricted fund, it is earmarked for sexual abuse claims and related expenses. Therefore, it is assumed to be restricted and unavailable (not “free”) in the analysis

**EQUALS: “FREE CASH RESERVES”**

#### *Detailed Description of the “Indirect Method”*

In past years, I used what is referred to in my report and in Attachment I as the “Indirect Method” to calculate ‘free cash reserves’. Although this “Indirect Method” appears to be somewhat complicated, it is really quite simple and results in exactly the same answer as the “Direct Method” described above. This “Indirect Method” is calculated exactly the same way as the “Direct Method” except for the last step. The last step is calculated differently as follows (note, once again, however, that the final result is exactly the same):

Compare the **RESULT** above to unrestricted net assets (exclusive of the “Uninsured Perils Fund”) entity by entity. Take the lesser of the **RESULT** or the unrestricted net assets entity by entity and then combine such lesser amounts for all entities. This combined amount represents “Free Cash Reserves” for the entire DRVC (Theory of this step: If unrestricted net assets for a particular entity are less than the **RESULT** for such entity, it means that such entity’s unrestricted assets exclusive of cash are less than such entity’s unrestricted liabilities. Therefore, the entity has a “net liability” exclusive of cash, and the unrestricted cash must be reduced by such net liability to determine the amount that is freely available for use in operations. Taking the lower of the **RESULT** and unrestricted net assets effectively accomplishes this reduction, and derives the same amount of “free cash reserves” as does the “Direct Method”).

## **ATTACHMENT VI: FORMULA USED TO CALCULATE “DEFINED OPERATING EXPENSES”**

Available non-profit industry benchmarks compare cash reserves and unrestricted net assets to annual operating expenses to determine how many years worth of operating expenses exist in the form of cash reserves and/or unrestricted net assets. In the case of the DRVC, this comparison is difficult because the DRVC does not issue combined financial statements, and many of its activities are self-supporting, i.e., they don't require annual fundraising to subsidize expenses. Therefore, DRVC expenses must be adjusted to eliminate all third party reimbursements (Medicare, Medicaid, cemetery fees, tuition, royalties, subscription fees, etc.), assessments, which effectively pass-through the expenses to others (self-insurance premiums), and other predictable and sustainable sources of income, which relate to self-supporting activities. In addition, inter-diocesan transactions (primarily subsidies and/or grants) also need to be eliminated since they are effectively counted twice when combining individual operating entity expenses. The end result of these eliminations is a combined "defined operating expense" amount representing the amount of operating expenses that must be subsidized each year via fundraising activities. Comparing this amount to free cash reserves and unrestricted net assets is more meaningful than a comparison involving total operating expenses.

**The specific formula used to make these adjustments and calculate combined “defined operating expenses” is as follows:**

Determine the total expenses for each Diocesan entity from the related financials

Eliminate inter-Diocesan subsidies included in expenses, which are effectively counted twice when combining expense amounts

Eliminate any non-operating expenses, one-time/non-recurring items, the cumulative effect of accounting changes and any prior year corrections of an error

Eliminate intra-Diocesan interest expense, distributions and/or amounts available to participants together with related investment management expenses (these items exist only in Unitas' financials after fiscal 2005)

Deduct third party reimbursements, assessments and other revenue that relates to self-supporting activities, e.g., Medicare and Medicaid reimbursements, tuition, subscription fees, royalties, cemetery fees, insurance assessments, fees for services, etc. Do not reduce expenses by investment income or by revenue produced through fundraising or similar development activities. If reimbursements exceed operating expenses for a particular entity, thereby producing a net negative expense amount, it is assumed that defined operating expense equals zero for that particular entity vs. a negative amount.

**Total all of the above. The end result equals “DEFINED OPERATING EXPENSES” on a combined basis (NOTE: The actual calculation is available upon request)**

**ATTACHMENT VII: ANALYSIS OF SEPTEMBER 6, 2006 LONG ISLAND CATHOLIC ARTICLE, “DIOCESAN RESERVES EXPLAINED”**

On September 6, 2006, The Long Island Catholic published a two page article entitled, “Diocesan Reserves Explained”. This article acknowledged the existence of \$200.4 million of unrestricted net assets (“reserves”), which basically confirmed my 2005 analysis. However, the article also attempted to justify the need for these reserves. Unfortunately, the justifications were more noteworthy for what they didn’t say than what they did say and for providing more misleading information, inaccuracies and half-truths. My analysis of what the article said and didn’t say is summarized below:

<b><u>WHAT IT SAYS</u></b>	<b><u>WHAT IT DOESN’T SAY</u></b>
<b>Overall summary:</b> Acknowledges the existence of \$200.4 million of unrestricted, cash net assets (“reserves”), including \$12.5 million of <u>undesignated</u> reserves and \$187.9 million of <u>designated</u> reserves	Does not explain that most of the “designations” are discretionary, subjective, vague, redundant and/or inconsistent with past practice and experience; leaves the mistaken impression that most of these reserves are needed for a specific purpose, which is highly doubtful
Provides a summary of individual entity operating results and combined unrestricted net assets (“reserves”) together with the Diocesan justification for such reserves; repeats most of the same arguments used in the past for maintaining such large reserves	Does not provide any combined information (other than unrestricted net assets); does not provide any new information or arguments; does not address my arguments against such large reserves; still does not include any Catholic Health Services financial information
Discusses the difficult operating environment and the operating deficits being experienced by many of the Diocesan operating entities	Does not mention that on a combined basis the Diocese had an operating surplus---net assets increased \$15 million in the past two years (\$5.5 million in 2005)---or that free cash reserves increased \$24 million in the past three years; fails to mention that the Diocese has virtually no debt and has many significantly undervalued assets
Argues that the reserves arbitrarily referred to as “quasi-endowment” funds are needed to generate income to support operations (see notes h and k)	Does not mention that these funds are completely unrestricted and were created from the contributions of and assessments on parishioners who had a right to expect them to be used for current operations vs. socked away for a rainy day; also does not mention the ability that the Diocese has to “tax” parishes and, therefore, to exist

	comfortably without “quasi-endowment” funds
Argues that many needs exist with respect to aging parish facilities and schools and that The Mission Assistance Fund will be used to address some of these needs (see note j)	Fails to mention that the Diocese has provided only an immaterial amount of financial assistance to the parishes or their schools since Jubilee 2000 and that the Diocesan response to the parish school crisis has been to form a new foundation--- Tomorrow’s Hope---vs. using the funds “designated” for such assistance; fails to mention that The Mission Assistance Fund has existed for some time now without being used to any great degree to address these needs (Note: The \$10.5 million of parish borrowing mentioned is the amount of parish loans outstanding, not the amount loaned---less than zero on a net basis---in 2005 as implied)
Argues that since most of the reserves are “designated” for a specific purpose the Bishop has “no intention of invading these funds”	Fails to mention that the Bishop is the one who designated such reserves and that he also has the power to un-designate them; fails to mention that the purposes designated are discretionary, subjective, vague, redundant and/or inconsistent with past practice and experience; does not provide any detailed support for such designations or other information to disprove their apparent lack of substance
Argues that only \$33.3 million of “central diocesan funds” can be “tapped to address the needs in other entities” (e.g., parishes, schools, ministries, etc.)	Fails to mention that the other \$167.1 million of <u>non-central</u> funds have been tapped for other purposes in the past, e.g., \$16 million of Catholic Cemetery reserves have been “tapped”; fails to mention that the “needs in other entities” could be addressed <u>directly</u> with these non-central funds, e.g., the excess insurance funds could be used to reduce future premiums paid by the parishes and ministries since they have obviously been significantly over-charged in the past in what amounts to a hidden “tax”
Suggests that the \$64.9 million of unrestricted self-insurance reserves is needed for “claims, deductibles, uninsurable losses, and loss prevention initiatives” (see note g)	Fails to mention that this \$64.9 million is over and above the amount determined as necessary by the Diocesan independent actuary and independent accountant, probably using very conservative methods

<p>Notes that Catholic Charities has \$19.9 million designated as a “quasi-endowment fund” for “programs in keeping with the intention of the initial bequest” (see note h)</p>	<p>Fails to mention that the original restrictions on this bequest have lapsed and that it is now completely unrestricted; fails to mention that this “quasi-endowment” fund has been allowed to double vs. being used for the “programs in keeping with the intention of the initial bequest”</p>
<p>Says that \$37.3 million of Catholic Cemeteries reserves are needed “to support perpetual care for older cemeteries and mausoleums (see note c)</p>	<p>Fails to mention that there is a separate \$55.2 million <u>restricted</u> reserve established for this purpose, which is all the independent auditors require; fails to mention that the level of historical operating expenses does not justify an additional reserve of nearly this much</p>
<p>Says that “many not-for-profit organizations have generated significant investment portfolios, which operate as quasi-endowment funds”, inferring that it’s alright for a religious institution to do the same</p>	<p>Fails to mention that the Church is not like “many not-for-profit organizations” in that it has the ability to “tax” its parishes and has a large permanent base of constituents upon which it can draw in a time of need; fails to mention that those who contributed these quasi-endowment funds (via Sunday collections and other means) had a right to expect them to be used currently rather than saved for a rainy day</p>
<p>Compares the Diocese to a family which “needs personal savings to cushion for emergencies and expected obligations”</p>	<p>Fails to mention that families don’t have the same ability to “tax” constituents when they need to; fails to mention that many of the Diocesan reserves are designated for subjective, uncertain (unexpected?) obligations, not just “expected obligations”</p>
<p>Says the Diocese will continue to carryout its “mission within the framework of transparent and open financial disclosure”</p>	<p>Does not say how the Diocese has met this test of “transparent and open disclosure” (Note: In my opinion, the Diocese has a long way to go); nor does it address the view of nearly 7,000 faithful that a mechanism for balancing spending priorities is sorely needed</p>
<p>Says the Diocese needs the \$200.4 million in cash reserves to assure that it can fulfill its mission in the future</p>	<p>Does not present persuasive evidence; does not compare this amount to any industry standards or other benchmarks; does not comment on the benchmarks I used in my analysis; does not address the philosophical difference implicit in gospel-oriented stewardship vs. the form of stewardship being practiced by the Diocese</p>

## **ATTACHMENT VIII: SELECT FINANCIAL METRICS FOR 2006**

(Amounts Are In Thousands)

<b>ENTITY</b>	<b>UNR. CASH + MKT SEC</b>	<b>TOTAL ASSETS</b>	<b>TOTAL LIABILITY</b>	<b>NET ASSETS</b>	<b>UNRESTR NET ASST</b>	<b>TO RE</b>
Administrative Offices---See Note (4)	\$46,572	\$94,247	\$36,218	\$58,029	\$47,572	\$40
Mission Assistance Corporation	4,688	6,349	-	6,349	6,349	6
Unitas Investment Fund, Inc.	-	397,906	397,906	-	-	18
Protected Self Insurance Program	71,598	143,942	87,442	56,500	56,500	33
Health Insurance Program	24,585	27,514	4,189	23,325	23,325	33
Catholic Charities	20,340	44,521	17,841	26,679	24,828	32
Catholic Cemeteries	114,623	129,623	3,898	125,725	125,714	14
Telecare	-	1,074	359	715	715	4
Catholic Press Association	2,071	2,631	89	2,542	2,542	2
Diocesan High Schools	3,844	16,862	11,575	5,287	3,176	36
Tomorrow's Hope Foundation, Inc.	397	535	538	(3)	(3)	1
Seminary of Immaculate Conception	677	3,632	193	3,439	1,862	3
Propagation of the Faith and Mission Office	1,612	1,949	713	1,236	973	1
Diocesan Service, Inc	231	244	91	153	153	
Ecclesia Assurance Company	2,709	4,445	1,624	2,821	2,821	2
<b>COMBINED TOTALS</b>	<b>\$293,947</b>	<b>\$875,474</b>	<b>\$562,676</b>	<b>\$312,797</b>	<b>\$296,527</b>	<b>\$232</b>

**NOTES:** (1) The entities presented are the only ones for which the DRVC has published financial statements; (2) Since eliminations of inter-diocesan amounts is possible given the limited information provided by the DRVC, the combined amounts presented could be inaccurate and misleading; (3) Unrestricted Cash and Marketable Securities has been derived by adding all cash and marketable securities and then deducting restricted investments, other restricted net assets and any funds held in custody, including pooled investment fund deposit liabilities. Total cash and marketable securities before making these deductions equals \$699 million; (4) Excludes \$13.4 million cumulative effect of accounting change